



**DEFENSE CONTRACT AUDIT AGENCY**  
**DEPARTMENT OF DEFENSE**  
8725 JOHN J. KINGMAN ROAD, SUITE 2135  
FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PAC 730.3.B.01/2004-11

August 16, 2004  
04-PAC-047(R)

**MEMORANDUM FOR REGIONAL DIRECTORS, DCAA**  
**DIRECTOR, FIELD DETACHMENT, DCAA**

**SUBJECT: Audit Guidance on Revisions to FAR Part 31 Under FAC 2001-024**

FAC 2001-024 revised five cost principles. The revisions are effective on contracts awarded on or after July 19, 2004. The most significant revision is the deletion of FAR 31.205-24, Maintenance and repair costs (FAR Case 2002-008) because both Cost Accounting Standards (CAS) and Generally Accepted Accounting Principles (GAAP) adequately address these costs. The other revisions are to improve the clarity and structure of the cost principles at FAR 31.204, Application of principles and procedures (FAR Case 2002-006); FAR 31.205-7, Contingencies; FAR 31.205-26, Material costs; and, FAR 31.205-44, Training and education costs. These revisions under this FAC do not change the substance of the cost principles.

Specific changes to the cost principles language are included in the enclosure in line-in line-out format and summarized below:

1. FAR 31.204, Application of principles and procedures –
  - Restructure paragraph b into subparagraphs- (b)(1), (b)(2), and paragraph (c).
    - Subpart (b)(1) shows the subcontract types itemized.
    - Subpart (b)(2) reflects the following statement:
      - i. The requirements of paragraph (b)(1) of this section apply to any tier above the first firm-fixed-price subcontract or fixed-price subcontract with economic price adjustment provisions.
    - The paragraph (c) was re-designated (d).
2. FAR 31.205-7, Contingencies.
  - Editorial changes to update references in paragraph (c)2.
3. FAR 31.205-24, [Reserved]
  - The text of the Maintenance and Repair cost principle was deleted in its entirety and FAR 31.205-24 was redesignated as [Reserved].
4. FAR 31.205-26, Material costs –
  - Editorial changes were made to paragraphs (a), (b), (d), and (e).
5. FAR 31.205-44, Training and education costs
  - Editorial changes were made to paragraph (f) to update references.

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SUBJECT: Audit Guidance on Changes to FAR Part 31 Amended by FAC 2001-024

If FAO personnel have any questions, they should contact regional personnel. If regional personnel have any questions, they should contact Rose M. Autmon, Program Manager, Accounting and Cost Principles Division, at (703) 767-3251 or DCAA-PAC@dcaa.mil.

/Signed/

Robert DiMucci  
Assistant Director  
Policy and Plans

Enclosure

Changes to Specified Provisions of FAR Part 31.2 (Line-In/Out)

DISTRIBUTION: C

## Changes to Specified Provisions of FAR Part 31.2

### Line-In/Out

(Changes published in FAC 2001-24, dated June 18, 2004 are noted with underline for additions to the current text and ~~striketrough~~ for deletions).

#### 31.204 Application of principles and procedures.

(a) Costs are allowable ~~shall be allowed~~ to the extent they are reasonable, allocable, and determined to be allowable under 31.201, 31.202, 31.203, and 31.205. These criteria apply to all of the selected items that follow, even if particular guidance is provided for certain items for emphasis or clarity.

(b) (1) For the following subcontract types, costs incurred as reimbursements or payments to a subcontractor under are allowable to the extent the reimbursements or payments are for costs incurred by the subcontractor that are consistent with Part 31:

(i) a Cost-reimbursement,

(ii) Fixed-price incentive, ~~or~~

(iii) Price redeterminable (i.e., fixed-price contracts with prospective price redetermination and fixed-ceiling-price contracts with retroactive price redetermination) type subcontract of any tier above the first firm fixed-price subcontract or fixed-price subcontract with economic price adjustment provisions are allowable to the extent that allowance is consistent with the appropriate subpart of this Part 31 applicable to the subcontract involved.

(2) The requirements of paragraph (b)(1) of this section apply to any tier above the first firm-fixed-price subcontract or fixed-price subcontract with economic price adjustment provisions.

(c) Costs incurred as payments under firm-fixed-price subcontracts or fixed-price subcontracts with economic price adjustment provisions or modifications thereto, ~~when~~ for which subcontract cost analysis was performed under 15.404-1(e), shall be ~~are allowable only to the extent that if~~ the price was negotiated in accordance with 31.102.

((ed)) Section 31.205 does not cover every element of cost. Failure to include any item of cost does not imply that it is either allowable or unallowable. The determination of allowability shall be based on the principles and standards in this subpart and the treatment of similar or related selected items. When more than one subsection in 31.205 is relevant to a contractor cost, the cost shall be apportioned among the applicable subsections, and the determination of allowability of each portion shall be based on the guidance contained in the applicable subsection. When a cost, to which more than one subsection in 31.205 is relevant, cannot be apportioned, the determination of allowability shall be based on the guidance contained in the subsection that most specifically deals with, or best captures the essential nature of, the cost at issue.

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#### 31.205-7 Contingencies.

\* \* \* \* \*

(c) \* \* \*

(2) Those that arise from presently known or unknown conditions, the effect of which cannot be measured so precisely as to provide equitable results to the contractor and the Government; e.g., results of pending litigation. Contingencies of this category are to be excluded from cost estimates under the several items of cost, but should be disclosed separately (including

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the basis upon which the contingency is computed) to facilitate the negotiation of appropriate contractual coverage. (See, for example, 31.205-6(g) and; 31.205-19, and 31.205-24).

\* \* \* \* \*

#### 31.205-24 Reserved.

#### ~~31.205-24 Maintenance and repair costs.~~

~~(a) — Costs necessary for the upkeep of property (including Government property, unless otherwise provided for) that neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient operating condition, are to be treated as follows (but see 31.205-11):~~

~~(1) — Normal maintenance and repair costs are allowable.~~

~~(2) — Extraordinary maintenance and repair costs are allowable, provided those costs are allocated to the applicable periods for purposes of determining contract costs (but see 31.109).~~

~~(b) — Expenditures for plant and equipment, including rehabilitation which should be capitalized and subject to depreciation, according to generally accepted accounting principles as applied under the contractor's established policy or, when applicable, according to 48 CFR 9904.404, Capitalization of Tangible Capital Assets, are allowable only on a depreciation basis.~~

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#### 31.205-26 Material costs.

(a) Material costs include the costs of such items as raw materials, parts, subassemblies, components, and manufacturing supplies, whether purchased or manufactured by the contractor, and may include such collateral items as inbound transportation and intransit insurance. In computing material costs, the contractor shall consider ~~consideration shall be given to~~ reasonable overruns, spoilage, or defective work (unless otherwise provided in any contract provision relating to inspecting and correcting defective work). ~~These costs are allowable, subject to the requirements of paragraphs (b) through (e) of this section.~~

(b) The contractor shall—

(1) Adjust the c~~Costs of material shall be adjusted~~ for income and other credits, including available trade discounts, refunds, rebates, allowances, and cash discounts, and credits for scrap, salvage, and material returned to vendors; and

(2) Credit s~~Such income and other credits shall either be credited~~ directly to the cost of the material or allocate such income and other credits ~~be allocated~~ as a credit to indirect costs. When the contractor can demonstrate that failure to take cash discounts was reasonable, the contractor does not need to credit ~~lost discounts need not be credited.~~

(c) Reasonable adjustments arising from differences between periodic physical inventories and book inventories may be included in arriving at costs; provided such adjustments relate to the period of contract performance.

(d) When materials are purchased specifically for and are identifiable solely with performance under a contract, the actual purchase cost of those materials should be charged to the contract. If material is issued from stores, any generally recognized method of pricing such material is acceptable if that method is consistently applied and the results are equitable. ~~When estimates of future material costs are required, current market price or anticipated acquisition cost may be used, but the basis of pricing must be disclosed.~~

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(e) Allowance for all materials, supplies and services that are sold or transferred between any divisions, subdivisions, subsidiaries or affiliates of the contractor under a common control shall be on the basis of cost incurred in accordance with this subpart. However, allowance may be at price when —

(1) ~~It~~ is the established practice of the transferring organization to price interorganizational transfers at other than cost for commercial work of the contractor or any division, subsidiary or affiliate of the contractor under a common control; and

(2) ~~when~~ The item being transferred qualifies for an exception under 15.403-1(b) and the contracting officer has not determined the price to be unreasonable.

(f) When a commercial item under paragraph (c) of this subsection is transferred at a price based on a catalog or market price, the ~~contractor—~~

(1) ~~Should adjust the price should be adjusted~~ Should adjust the price to reflect the quantities being acquired; and

(2) ~~May be adjusted the price~~ May be adjusted the price to reflect the actual cost of any modifications necessary because of contract requirements.

\* \* \* \* \*

31.205-44, Training and education costs.

\* \* \* \* \*

(f) Other expenses. Maintenance expense and normal depreciation or fair rental on facilities owned or leased by the contractor for training purposes are allowable in accordance with 31.205—11, 31.205-17, ~~31.205-24~~, and 31.205-36.